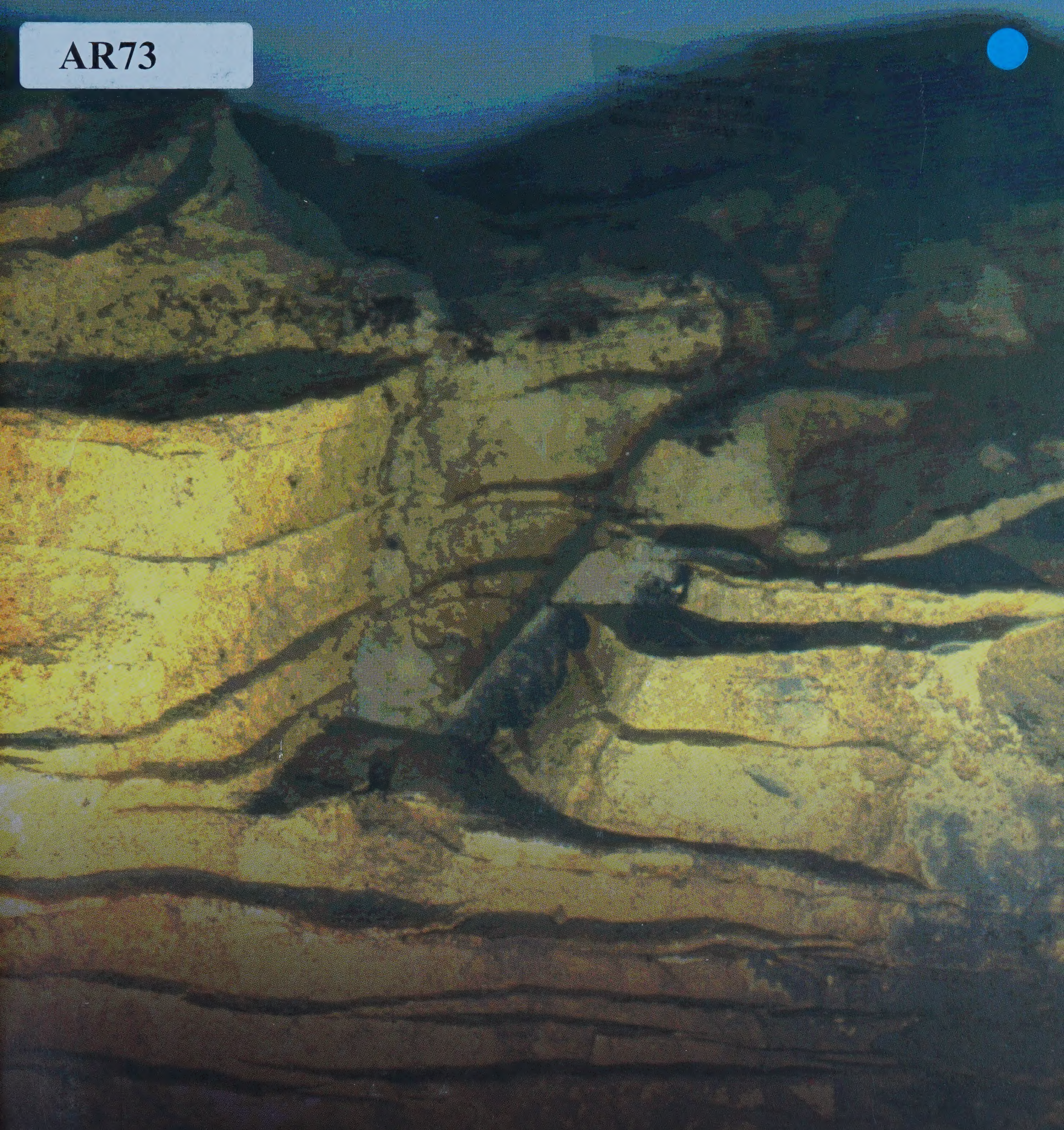


Endless Energy Corporation

2001 Annual Report

Corporate Profile

Endless Energy Corporation is a Canadian junior oil and gas exploration and development company with production in Alberta and British Columbia. Endless Energy is also participating in two major exploration projects offshore near Sable Island, Nova Scotia.

Endless Energy is a prospect generating company that commenced operations in 1997 with a small, dedicated technical team who, combined, have over 400 years of experience in the oil and gas industry.

Common shares of Endless Energy Corporation trade on the TSX Venture Exchange under the symbol EEC.

Contents

Annual General Meeting

The Annual General Meeting of Shareholders will be held on Tuesday, June 18, 2002 at 9:00 a.m. in the Aquitaine Auditorium, 2nd floor, 540-5th Ave SW, Calgary, Alberta. Those shareholders unable to attend are encouraged to complete and return the form of proxy mailed to the shareholders with this annual report.

"Over the course of the last financial year, we have doubled the production attained by the end the previous year. By the end of May 2002, we anticipate that production will have doubled again..."

2001 Highlights

- Acquired Valkyrie Resources Ltd. in July 2001
- Kevin Dickson becomes Vice-President, Production
- Victor Skurat, an international securities analyst, becomes a Director
- Pocketknife well put on stream January 2001
- Lucy property, surrounded by 96 gas wells, is ready for drilling
- Sounding Lake site optimization increased gas production by 50 percent
- Revenue increased almost 500 percent from the 2000 financial year

	2001	2000
Cash on hand	$ 762,000	$ 35,000
Plant and equipment	$ 1,820,000	$ 1,770,000
Revenue	$ 691,000	$ 139,000
Production	73 BOE/day	25 BOE/day

Jon Axford, President

Endless Energy Corp. commenced operations on April 1, 1998. Its team of executives was remarkable for the breadth of seasoned talent they brought to the organization. Today, their combined experience in the corporate oil world exceeds 400 years-- many times the average for a company of modest size. The potential advantage of having such a mature team of specialists is immense and I believe that it will profoundly influence the plays that Endless Energy makes over the near and medium term.

In the four years since its inception, the company has acquired the mineral rights to more than 1.6 million acres of drillable property, in both promising and proven geological areas. These acquisitions typically provide us with three options. The most obvious option is for us to drill for oil and gas in new locations. A decision to drill in a new area is relatively 'high risk', with the possibility of 'high reward'. The second option is to carefully assess the potential of proven projects which were abandoned in the past due to economic factors or time constraints. Some of these can be made into producing wells through a skillful engineering process called "optimization". The third option is to share the cost of drilling with one or more partners, which reduces risk at the drilling stage, but also results in sharing production in the case of a discovery.

Over the course of the last financial year, we have doubled the production attained by the end the previous year. By the end of May 2002, we anticipate that production will be doubled again due to the new Sounding Lake gas well. Undeveloped land holdings at December 31, 2001 are 1,627,073 gross acres and 15,577 net acres. Our western Canadian holdings account for 39,946 gross acres and 11,609 net acres.

Last year was a difficult one for the oil industry, with the drop in both oil and natural gas prices affecting capital spending plans for exploration and development on an industry-wide basis. The tragedy of September 11th and other economic conditions reverberated through the economy, with a corresponding impact on the energy sector. However, we believe that stability in commodity prices and overall economic conditions in recent months will have positive implications for the company in 2002.

> "In the four years since its inception, the company has acquired the mineral rights to more than 1.6 million acres of drillable property, in both promising and proven geological areas"

The history of the energy sector is a turbulent one, especially in the last three decades. Several interrelated factors are responsible for the large swings that we have seen in the supply of oil and gas. Foremost among them is the steady growth in product demand as it responds to volatility in foreign-controlled supply. A second element can be found in the decline of newly discovered reserves, particularly accessible domestic reserves. As North American economies look further afield to satisfy their appetites for hydrocarbon fuels, they are at the mercy of resource supplies that are increasingly affected by policies created elsewhere. Obviously, a secure domestic supply will become more valuable over time, and Endless Energy is well positioned to capitalize on this emerging trend. A third aspect of the turbulence in the industry is related to a shift in technology which makes clean-burning natural gas a valuable alternative to oil.

Many people do not recall a time when natural gas was not commercially viable, yet until relatively recently, many oil companies actually disposed of it as an unwanted by-product of the extraction process. With public demand for smog reduction in urban centres, the future of commercial fleets as well as private vehicles is a real and exciting trend for the gas industry. Projected demand over time is predicted to skyrocket, and this will be reflected in a higher average product price. By targeting natural gas deposits in both the Western Canadian Basin and the Offshore Atlantic region, Endless Energy is deliberately placing itself in the path of the long-term price increases that are already becoming evident.

"Our diversified landholdings in both eastern and western Canada place us in a position from which this company can grow."

Endless Energy Corp. is a prospect-generating company. Our strategy for growth continues to focus on the acquisitions of undeveloped or underdeveloped land, using our expertise to assess and develop prospects. With an established land base, we then take on partners as a way of sharing the relatively high costs of drilling. This approach capitalizes on the strength of our professional team without allocating a disproportionate amount of our working capital to any one project. We view this strategy as a prudent and intelligent way for growth.

We repositioned ourselves for growth in 2001 with the addition of Kevin Dickson as Vice-President of Production. Kevin's expertise complements Endless Energy's management team and provides the company with opportunities to increase and optimize output on its producing properties. The most obvious benefit of his work will be to improve cashflow from both existing and new wells. We were also fortunate in adding Victor Skurat with his financial acumen to our team. Victor has 21 years of experience as a Securities Analyst and Corporate Finance Specialist. Combining his ability in corporate financial matters with Kevin's expertise in maximizing extraction potential will, in my opinion, accelerate the growth of the company.

I feel honoured to have access to such capable people. A quick review of the group reveals the following:

Donald W. Axford is the recipient of a gold medal presented by the Canadian Society of Petroleum Geologists for outstanding contributions to petroleum developments in the Canadian Offshore Atlantic. His resume includes ten directorships and executive positions in six oil companies over the years.

Kevin Dickson, our Vice-President of Production, is a petroleum engineer with over twenty years of oil experience in western Canada, primarily in acquisitions, production operations, and optimization. He is President of Dagur Resources, a consulting firm to the oil and gas industry, and is on the Board of Directors for two public companies.

Dr. John Andrichuk, a PhD in Geology, has co-owned an independent geological consulting firm for many years. In addition to his work with many of Canada's foremost oil companies, he has published numerous papers and is considered an authority on hydrocarbon deposits in western Canada.

Dr. Oscar Erdman spent many years in senior geological positions, including Manager of Exploration for Gulf Oil Canada Ltd. He founded Erdman Resource Consultants Ltd. over 20 years ago and has since consulted on many projects with Canadian oil companies. His body of published work demonstrates a broad understanding of the oil

industry in Alberta.

B. J. Seaman, an engineer and geophysicist, was for many years Chairman and CEO of Bovar Inc., a company that services the oil industry. Early in his professional career, he taught mechanical engineering at the University of Saskatchewan, before moving to the private sector. His understanding of the mechanics of oil production is humbling. He holds directorships in several oil-related companies.

Dr. Ralph Edie is a geologist and mining engineer. Formerly employed by Shell Oil Co. and Texaco Exploration Co., he co-founded the firm Andrichuk and Edie, Consulting Geologists. He has authored oil-related geological papers on Alberta, Saskatchewan, and the Mackenzie District of the Northwest Territories.

Victor Skurat, an MBA graduate, has worked in the fields of finance, securities, and investment since 1980. He has over eight years of business development experience in Europe, Africa, and South Asia. His talent for the detailed financial analysis of global energy developments provides a complementary function to the engineers and geologists on the team. He is also experienced in managing risk exposure by using oil and gas futures markets.

Larry Martin is a chartered accountant with more than twenty-two years of public practice. He has served as CFO for several public and private corporations. His professional emphasis is in tax, financial planning, corporate finance and risk management.

W. H. Smith, a senior partner in Canada's largest legal firm, is a specialist in securities law. He has been actively involved in some of the largest oil and gas transactions in western Canada. His keen legal mind helps round out the group of talented people with whom I have the privilege of working.

My background is in mathematics and economics and I hold a B.Sc. from the University of Alberta. I am a member of the Canadian Association of Petroleum Landmen. For over 22 years I have sourced and negotiated all aspects of oil and gas contracts. My major focus is to coordinate the strategies and individual plays put together by Endless Energy's talented team.

Endless Energy was built on the talent and commitment of its staff and advisors. Our diversified landholdings in both eastern and western Canada place us in a position from which this company can grow. I look forward to a prosperous 2002.

On behalf of the Board of Directors,

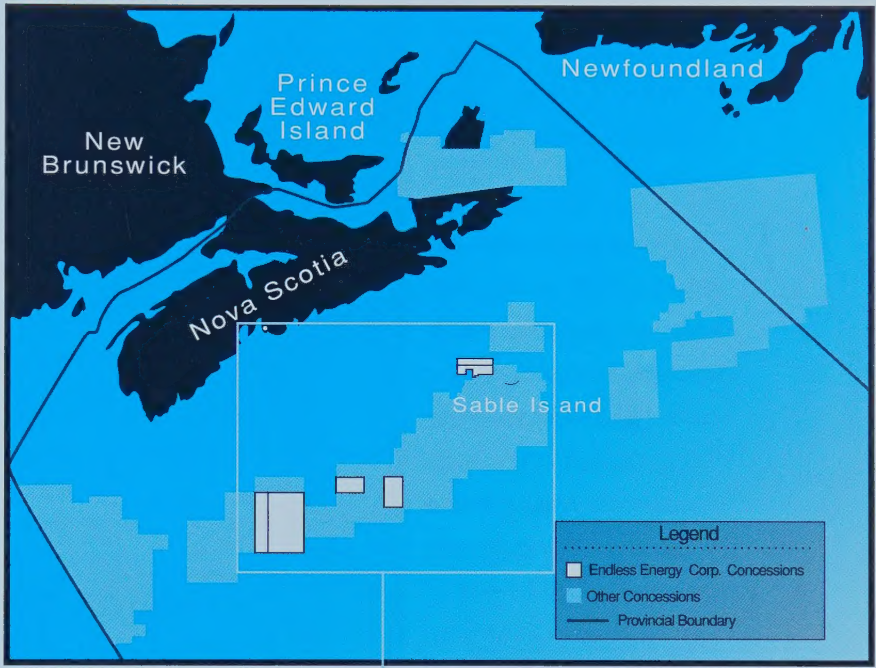
D. Jon Axford, President
May 10, 2002

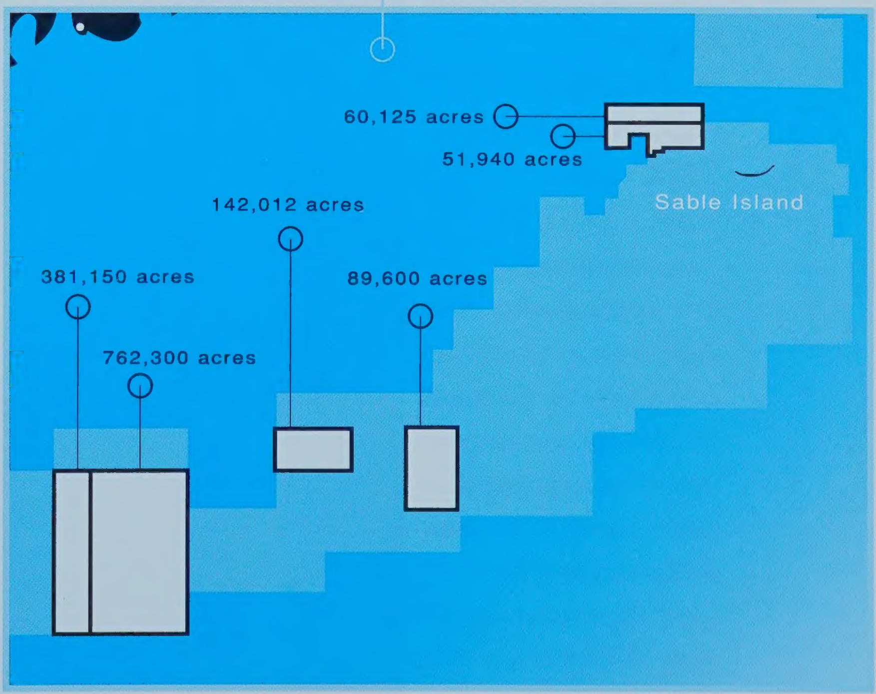
Endless Energy has two distinct property groupings-- one in the Offshore Atlantic near Sable Island (see map), and the second one in Alberta and northeastern British Columbia. Each of these areas has a particular character which requires a specific geological and engineering approach.

The Sable Island properties are comprised of six parcels off the coast of Nova Scotia where Endless Energy holds a gross overriding royalty. One prospect is in shallow water off the mainland side of the island. It occupies more than 100,000 acres in a location only 18 miles from an Encana Corporation well which has been assessed to contain at least one trillion cubic feet of natural gas. In terms of the geology of the seabed, 18 miles is equivalent to being across the back fence from the Encana site. Based on the detailed seismic data available, two wells are scheduled to be drilled this year on Endless Energy leases. The first one is looking for a Jurassic reef and the other for deep-water turbidites. The reef test is set to go by the end of June; the second later in the fall. Our share from the gas or oil found is based on a gross overriding royalty which is cost free. With over 1,500,000 acres in the Offshore Atlantic region alone, Endless Energy is well positioned to benefit from east coast exploration.

Our western Canadian operations are spread over a large area in Alberta and northeastern British Columbia where we are employing two parallel strategies for growth: exploitation and exploration.

SABLE ISLAND





Exploitation

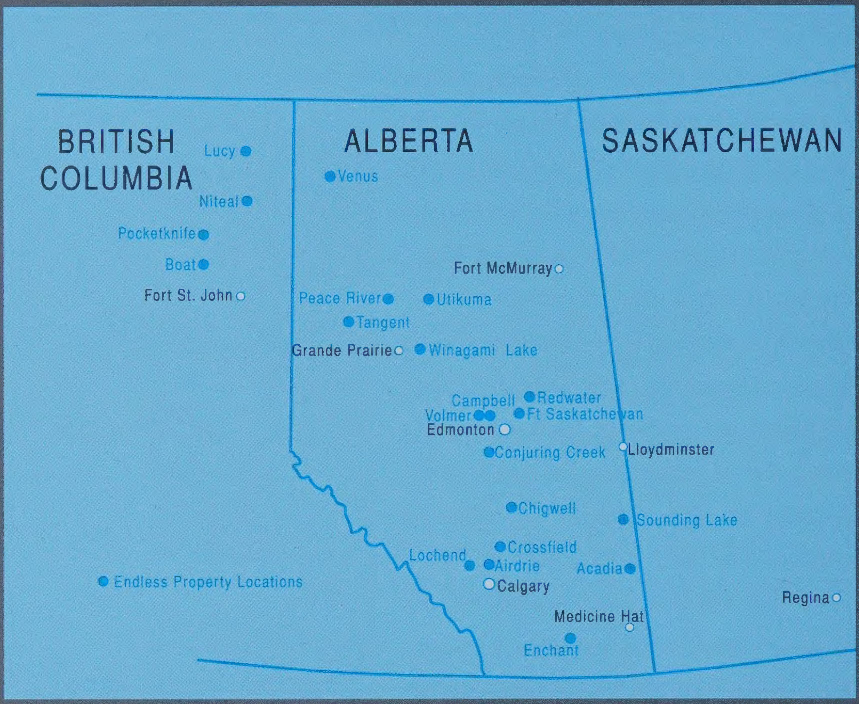
Kevin Dickson, our VP of Production, is responsible for reworks and optimizations. The properties we are currently developing are: Sounding Lake, Lucy, Redwater, Campbell, Enchant and Acadia.

At **Sounding Lake**, the recent rework of our 1-15 well has the potential to increase our production to over 100 BOE's per day. This project has now become one of our principal properties. The company will:

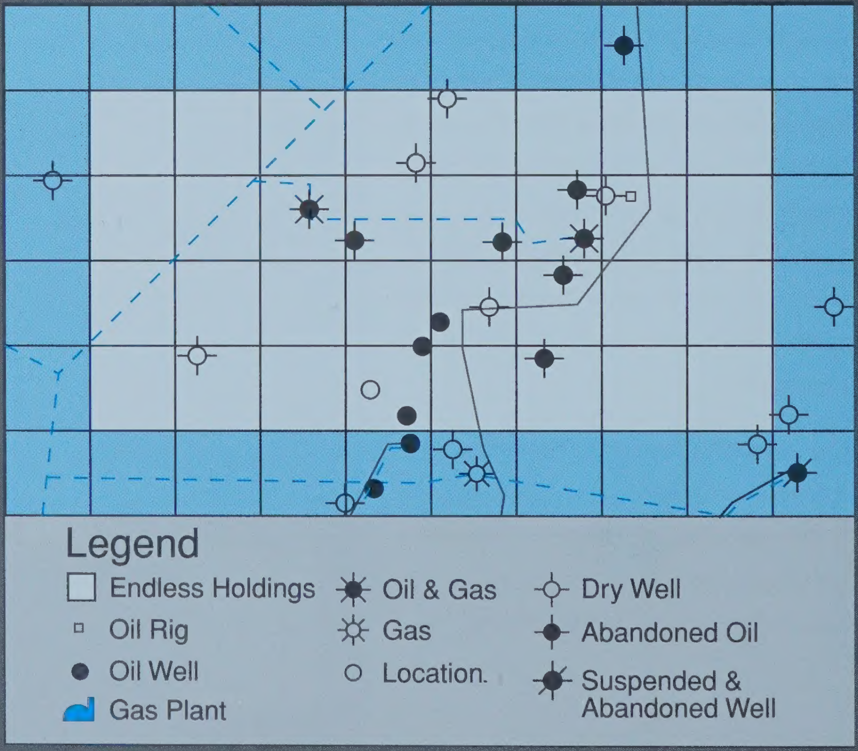
- produce the new well from the Colony zone;
- consider drilling an offset well;
- drill three additional locations for oil identified by 3D seismic;
- look at several other rework projects.

The company concurrently plans an optimization program on the Cummings 33° API oil zone and will consider the viability of a water flood or other secondary recovery program. There also exists an up-hole heavy-oil Lloydminister zone that can be exploited.

British Columbia & Alberta

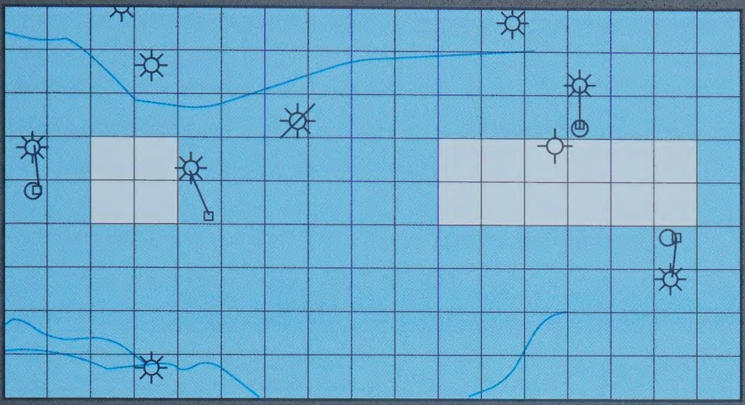


SOUNDING LAKE, Alberta

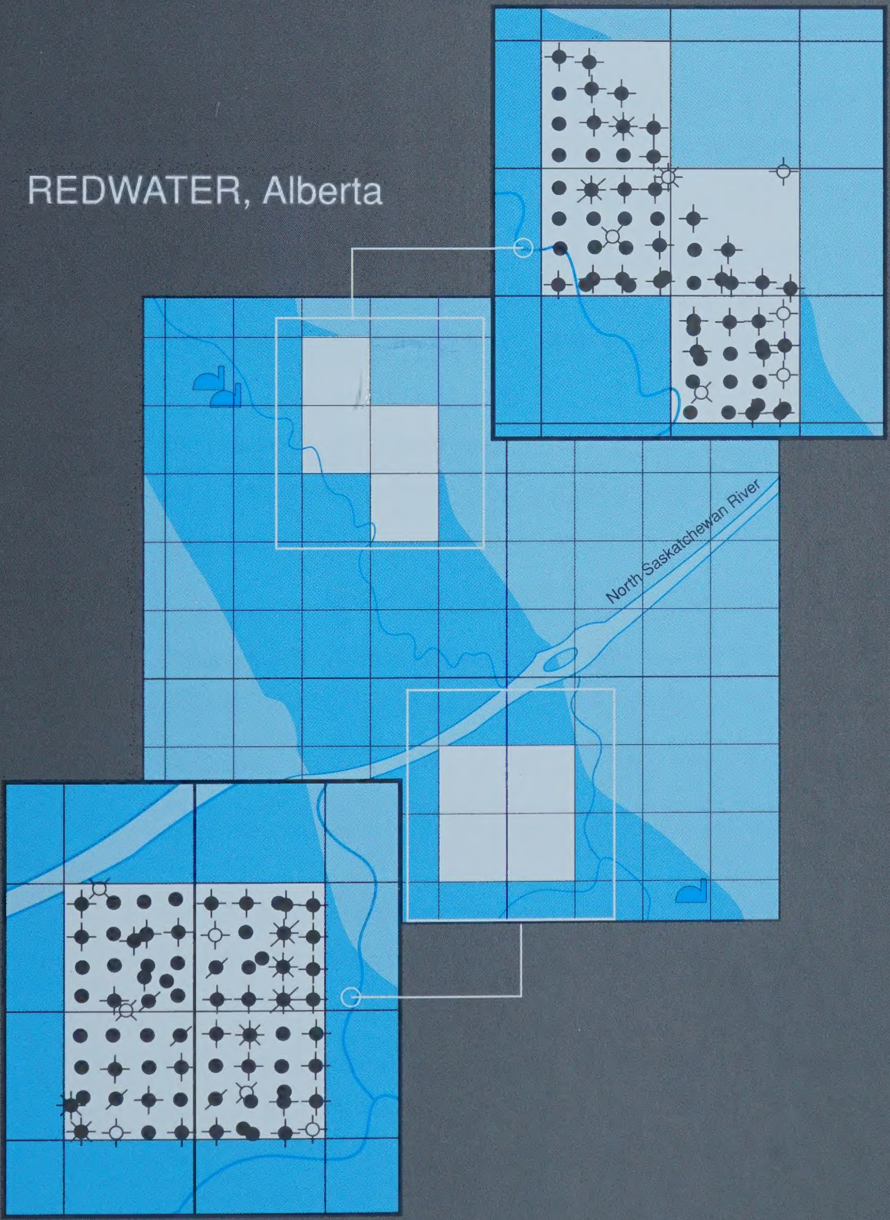


OPERATIONS REVIEW

LUCY, British Columbia



REDWATER, Alberta



Our **Lucy** property has been surrounded by 96 horizontal Jean Marie gas wells. We have three development locations available. The company owns a 66% working interest and is the operator. The first operation planned in this area will be a Keg River test, which the company plans to farm out, using an existing well-bore to slant over 1200 feet. The company owns a cased 7" 7200' vertical well which will save $1.5 million in drilling costs. This high-risk, high-reward prospect targets over 10 billion cubic feet of recoverable reserves. Should this deepened well not be successful in the Keg River, it can be completed in the Jean Marie.

Our **Redwater** property, after several delays, will be tested for Viking gas production. This well also has two other untested up-hole gas zones. With eight sections of nearby land, we have a good base for the exploitation of these

multiple gas zones. The company owns a 24% to 35% working interest and is the operator.

The **Campbell** property, which is currently producing 7.5 BOE/d, has one additional development location and two new exploratory locations. The company owns a 25% to 100% working interest on 2680 acres on this operated and non-operated property.

The **Acadia** property, located 130 miles east of Calgary, has one development location which we expect will be drilled in June of this year. It targets the Viking formation (gas). Two other up-hole zones (gas) have potential. We also have a suspended well-bore available for reworked production and/or a salt water disposal facility. The company owns a 42.5% working interest and is the operator.

Exploration

Our strategy for exploration growth continues to focus on the acquisition of undeveloped lands, using our wide access to expertise to develop prospects for our own drilling and for farmouts. Our hope is that by this process we will increase the assets and revenue of the company.

Enchant -The company owns 2560 acres which contain an interesting Glauconite oil channel. The Belly River, Viking and Arcs formations also have potential to produce gas. These targets are at shallow depths, near infrastructure, and provide good possibilities for development. The company owns a 45% working interest and is the operator.

Volmer -This is a Leduc pinnacle prospect with up-hole gas bailouts. The prospect is near Campbell and has potential for gas production in the Ellerslie formation. The company owns a 100% working interest and is the operator.

Redwater - Deep Devonian targets exist. The company plans to farm out these deeper targets.

Chigwell - This property contains two pinnacle Leduc oil targets and two up-hole gas targets. The company owns a 50% working interest and is the operator.

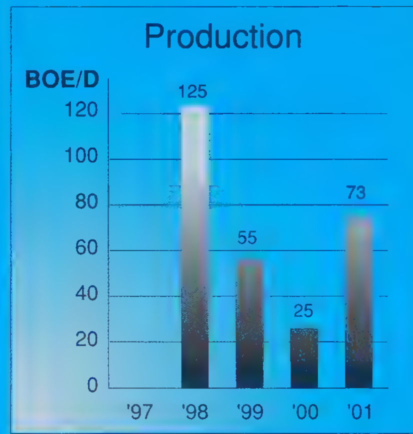
Sable Island

Two wells are scheduled to be drilled this year in areas where the company owns a quarter of one percent gross overriding royalty.

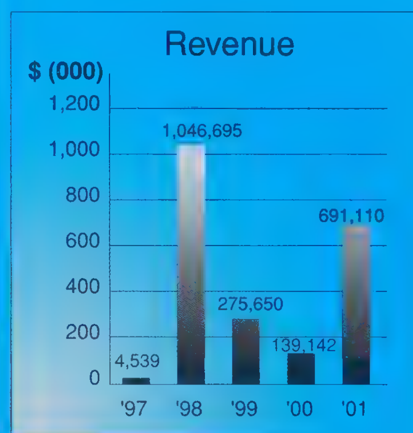
The following discussion and analysis should be read in conjunction with the Financial Statements and the accompanying notes.

Cash on hand at year-end is $762,000, compared with $35,700 the previous year. The company entered into flow-through and common share agreements at year-end. This was the first time in the company's history that we have had working capital.

Property, Plant and Equipment is $1.8 million, compared with $1.7 million in 2000. This difference reflects the acquisition of Valkyrie Resources Inc. The company has taken a ceiling test writedown of $465,000. This is from our Pocketknife property which has been reduced from $751,000 to $370,000. The Venus property has been written down from $382,000 to $143,000. This totals $620,000. Property additions of $500,000 from Campbell, Fort Saskatchewan and Sounding Lake make up the difference. Price forcasts used this year are $20.00 US per barrel and $2.20 US per mcf. Last year's forecasts were prepared based on $26.00 US per barrel (23% lower forecast this year) and $4.12 per mcf (46% lower forecast this year).



Depletion has increased from $41,524 in 2000 to $349,000. This is a direct result of the Pocketknife property going into production starting January 2001 and the Sounding Lake property producing commencing July 2001. These properties did not produce for the company in 2000.



Total current liabilities are $781,000, compared with $719,000 the previous year. These include the loan of $262,000 to consummate the Valkyrie purchase; otherwise liabilities were reduced by $200,000.

Shareholders Equity is $1.9 million, compared with $1.25 million for the year 2000. This increase is attributable to the year-end underwriting of flow-through and common shares and the purchase of Valkyrie Resources Inc.

Revenue increased 497% to $691,000 from $139,000 the previous year. The increase is due to the Pocketknife well coming on stream in December 2001, as well as increased production from the acquisition of Valkyrie in July 2001.

General and administrative expenses increased 33.5% to $418,000 from $313,000. One time acquisition costs and increasing administration of the assets account for the difference.

Endless Energy increased production in 2001 by 280% to 70 BOE/d at year-end, up from 25 BOE at the beginning of the year. Average price received for oil was $34.10/bbl during 2001 as compared to $38.79/bbl in 2000. Average gas price received during 2001 was $5.21/mcf as compared to $3.59/mcf during 2000.

Larry S. Martin, CA

Chief Financial Officer [illegible]

Donald W. Axford, B.Sc. Geology

Director, Geologist. Expert in [illegible] Gold medal recipient from the Canadian Society of Petroleum Geologists "for outstanding contribution to petroleum development in the Canadian Offshore Arena."

Bryon J. Seaman, Geophysicist, P.Eng. (Mech)

Director [illegible]

William H[illegible]

[illegible]

W. [illegible] Dickson, B.Sc. Petroleum Engineering

[illegible]

Victor Skurat, MBA (Finance), CFA

[illegible]

Ralph Ellis, PhD.Geology, P.[illegible]

[illegible]

PERSONNEL

…mith, Q.C., LLB

[illegible]

Barb Goodwin

[illegible]

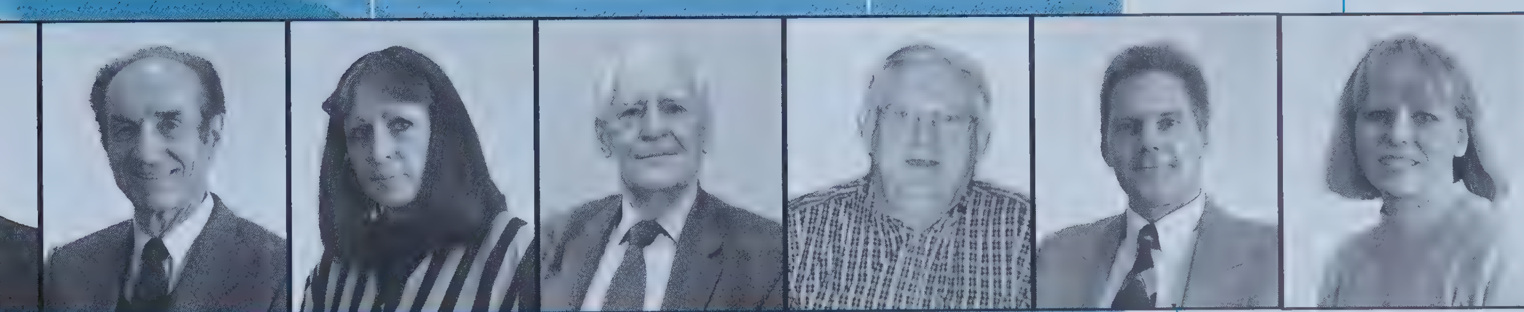
Howard Wells

[illegible]

Rosemary Kumlin

Accountant

Employed with private and public companies for over 1[illegible] years and [illegible] years ago.



John Andrichuk, PhD, Geology.

Exploration

With over 40 years in the field, he co-founded the firm Andrichuk & [illegible], consulting geologists.

Oscar Erdman, [illegible]

Exploration

Formerly [illegible] with Gulf Oil [illegible] of Erdman Reso[illegible] Consultants Ltd.

D. Jon Axford, B.Sc.

Director, President, CEO

Over 2[illegible] years experience as a landman in both Canada and the USA

MANAGEMENT'S REPORT

The management of Endless Energy Corporation is responsible for the preparation of the accompanying financial statements and all other information contained in this annual report. The consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada and according to the policies detailed in the notes.

The company maintains an appropriate system of internal controls to provide reasonable assurance that assets are properly safeguarded and the financial records are sufficiently well maintained to provide relevant, timely and reliable information to management.

Hudson and Company LLP, an independent firm of chartered accountants, has examined the financial statements and has provided a professional opinion on them, based on generally accepted auditing standards.

An Audit Committee of the Board of Directors has reviewed these consolidated financial statements with management and the external auditors. The Board of Directors has approved the financial statements based on the recommendation of the Audit Committee.

D. Jon Axford
President and Director

May 7, 2002

AUDITORS' REPORT

To the Shareholders of Endless Energy Corporation

We have audited the consolidated balance sheets of Endless Energy Corporation as at December 31, 2001 and 2000 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2001 and 2000 and the results of its operations and the changes in its financial position for the year then ended in accordance with Canadian generally accepted accounting principles.

Hudson & Company LLP

HUDSON & COMPANY LLP
Chartered Accountants

Calgary, Alberta
May 8, 2002

December 31	2001 $	2000 $
ASSETS		
Current		
Cash (Note 2)	762,042	35,737
Accounts receivable	133,683	311,552
Prepaid expenses	40,748	11,100
	936,473	358,389
CAPITAL ASSETS (Note 3)	1,832,296	1,767,428
	2,768,769	2,125,817
LIABILITIES		
Current		
Accounts payable	518,099	$ 718,967
Note payable (Note 5)	262,675	-
	780,774	718,967
FUTURE INCOME TAXES	40,872	152,362
SITE RESTORATION	24,700	4,000
	846,346	875,329
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 6)	2,429,528	1,296,786
DEFICIT	(507,105)	(46,298)
	1,922,423	1,250,488
	2,768,769	2,125,817

Commitments (Note 7)

Approved on behalf of the board

D. Jon Axford
Director

Donald W. Axford
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

Year ended December 31	2001 $	2000 $
REVENUE		
Petroleum and natural gas	691,110	139,142
Interest	877	25,008
	691,987	164,150
EXPENSES		
Depletion and amortization	814,000	41,524
General and administrative	418,234	312,868
Interest and bank charges	19,741	25,929
Operating	295,818	1,297
Site restoration	20,700	-
	1,568,493	381,618
Loss before income taxes	(876,506)	(217,468)
INCOME TAXES		
Future (recovery) (Note 9)	(415,699)	(30,669)
NET LOSS	(460,807)	(186,799)
RETAINED EARNINGS (DEFICIT), beginning of year	(46,298)	140,501
DEFICIT, end of year	(507,105)	(46,298)
Loss per common share (basic and diluted) (Note 6)	(0.066)	(0.034)

Years Ended December 31	2001 $	2000 $
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	(460,807)	(186,799)
Items not affecting cash		
Depletion and amortization	814,000	41,524
Future income taxes (recovery)	(415,699)	(30,669)
Site restoration	20,700	-
	41,806	175,944
Net change in non-cash working capital balances (Note 9)	(52,647)	160,110
Cash flows (used in) operation activities	(94,453)	(15,834)
CASH FLOWS FROM INVESTING ACTIVITIES		
Addition to petroleum and natural gas properties and equipment	(49,111)	(299,917)
Disposition of petroleum and natural gas properties and equipment	-	747,500
Cash flows from (used in) investing activities	(49,111)	447,583
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of share capital	974,864	91,032
Purchase of Valkyrie Resources Inc., net of cash assumed on purchase	(104,995)	-
Exercise of options	-	86,494
Cash flows from financing activities	869,869	179,526
INCREASE IN CASH	726,305	609,275
CASH (DEFICIENCY), beginning of year	35,737	(573,538)
CASH, end of year (Note 2)	762,042	(35,737)

DECEMBER 31, 2001 AND 2000

GENERAL

The Company was incorporated under the Business Corporations Act (Alberta) on March 27, 1997.

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Valkyrie Resources Inc.

Joint Venture Accounting

Substantially all of the Company's petroleum and natural gas activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

Capitalized Costs

The Company follows the full cost method of accounting whereby all costs related to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized in a Canadian cost centre and charged against earnings as discussed below. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on non-productive properties, costs of drilling both productive and non-productive wells, equipment costs and general and administrative expenses applicable to these activities.

Gains or losses on sales of properties are recognized only when crediting the proceeds to costs would result in a change of 20 percent or more in the depletion and amortization rate.

Depletion and Amortization

Depletion and amortization of petroleum and natural gas properties and equipment are provided for on the unit-of-production method based on estimated proven petroleum and natural gas reserves before any royalty deductions as determined by independent engineers. For the purpose of this calculation, petroleum and natural gas reserves are converted to a common unit of measurement on the basis of their relative energy content where six thousand cubic feet of gas equates to one barrel of oil. Costs of acquiring and evaluating unproven properties are excluded from costs subject to depletion and amortization until it is determined whether proven reserves are attributable to the properties or impairment occurs.

Computer equipment is recorded at cost and is amortized using an annual rate and method of 30% declining balance.

Site Restoration

The estimated costs of future removal and site restoration of petroleum and natural gas properties are provided for on the unit-of-production method. The annual charge is made to site restoration expense and actual site restoration expenses will be charged to the accumulated future site restoration account as incurred.

Ceiling Test

Each period the Company applies a ceiling test to capitalized costs to ensure that the net carrying value of petroleum and natural gas properties does not exceed the estimated value of future net revenues (calculated using prices at December 31, 2001) from the production of proven reserves, less related general and administrative expenses, financing costs, estimated future major development and site restoration costs and income taxes. Any impairment in value is charged to operations.

Earnings per share

On January 1, 2001 the Company adopted retroactively the treasury method of calculating fully diluted earnings per share as outlined in Section 3500 of the Handbook of the Canadian Institute of Chartered Accountants. There was no impact to the financial statements for the current or prior years as a result of this change in accounting policy. Basic earnings per common share are calculated by dividing net earnings applicable to common shares by the sum of the weighted average number of common shares outstanding and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued.

Flow through Shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow through share arrangements are renounced to investors in accordance with tax legislation. A future tax liability is

generated upon the issuance of such shares and the liability is reduced when the related expenditures are incurred.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under the asset and liability method, the change in future tax asset or liability is to be included in income. Future income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. Temporary differences arise from the difference between the tax and accounting bases of assets and liabilities.

Measurement Uncertainty

The amount recorded for the provision for depletion and amortization of the petroleum and natural gas properties and the provision for site restoration are based on estimates of reserves and future costs. The ceiling test calculation is based on estimates of proven reserves, production rates, petroleum and natural gas prices, future costs and other applicable factors. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of future years could be material.

2. CASH AND CASH EQUIVALENTS

	2001	2000
Cash is comprised of:		
Cash on hand and balances with bank	$ -	$ 35,737
Bank indebtedness	(45,669)	-
Cash held in trust	807,711	-
	$ 762,042	$ 35,737

Bank indebtness consists of cheques written in excess of funds held on deposit.

Cash and cash equivalents at December 31, 2001 include cash held in trust to be spent by the Company on exploration activities, while the income tax benefit will be renounced to the shareholders of the Company. The renunciation is required to be made by December 31, 2002.

3. CAPITAL ASSETS

			2001	2000
	Cost	Accumulated Amortization	Net Book Value	
Petroleum and natural gas properties and equipment	$ 3,055,439	$ 1,237,831	$ 1,817,608	$ 1,764,637
Computer equipment	21,396	6,708	14,688	2,791
	$ 3,076,835	$ 1,244,539	$ 1,832,296	$ 1,767,428

During the year the Company wrote down its petroleum and natural gas properties and equipment by $465,000, which has been included in the depletion and amortization expense.

Excluded from the depletion calculation of petroleum and natural gas properties and equipment is unproven lands in the amount of $719,000 (2000 - $1,000,000).

4. BANK LOAN

Revolving demand production loan with a borrowing base up to $150,000, collateralized by a $500,000 fixed charge petroleum and natural gas debenture, containing a first fixed charge on petroleum and natural gas assets, a general security agreement with floating charge on petroleum and natural gas assets, bearing interest at prime + 1.00% per annum. At December 31, 2001, the amount of the demand production loan was $nil (2000 - $nil)

5. ACQUISITION

On July 3, 2001, the Company acquired 100 percent of the outstanding common shares of Valkyrie Resources Inc. The aggregate purchase price was $650,000, including $160,000 cash, 400,000 common shares of the Company valued at $100,000 and promissory notes in the amounts of $390,000. During the year $130,000 was repaid. The remaining $260,000 promissory note plus interest at 10% per annum, was to have been repaid by February 15, 2002, but was not and the holder of

ACQUISITION (Continued)

the promissory note has agreed not to demand repayment. The results of Valkyrie's operations have been included in the consolidated financial statements since July 3, 2001.

The following table summarizes the estimated fair market value of the assets acquired and liabilities assumed at July 3, 2001:

Current assets	$	147,515
Petroleum and natural gas properties and equipment		801,459
Total assets acquired	$	948,974
Current liabilities	$	(61,524)
Future income tax liability		(237,450)
Total liabilities assumed		(298,974)
Net assets acquired	$	650,000

6. SHARE CAPITAL

Authorized

Unlimited number of common voting shares

Unlimited number of preferred shares, issuable in series

Issued and outstanding

	2001		2000	
	Number of Shares	**Consideration**	**Number of Shares**	**Consideration**
Common Voting Shares				
Balance, beginning of year	**6,091,824**	**$ 1,296,786**	5,041,824	$ 1,119,260
Shares issued , net of issuance costs and future income taxes	**4,426,525**	**1,032,742**	612,500	90,026
Shares issued for purchase of Valkyrie Resources Inc.	**400,000**	**100,000**	-	-
Exercise of options	**-**	**-**	437,500	87,500
Balance, end of year	**10,918,349**	**$ 2,429,528**	6,091,824	$ 1,296,786

A summary of the Company's stock options at December 31, 2001 and 2000 and the changes for the years ending on those dates is presented below:

	2001		2000	
	Options Outstanding	**Weighted Average Exercise Price**	**Options Outstanding**	**Weighted Average Exercise Price**
Balance, beginning of year	520,000	$ 0.29	400,000	$ 0.20
Granted	200,000	0.30	557,500	0.29
Exercised	-	-	437,500	0.20
Balance, end of year	720,000	$ 0.30	520,000	$ 0.29

At December 31, 2001, the Company has entered into stock option agreements, which are subject to regulatory approval, with certain of its directors, officers, and employees as follows:

Options Outstanding	**Exercise Price**	**Options Exercisable at December 31, 2001**	**Expiry Date**
420,000	0.30	420,000	May 15, 2005
150,000	0.30	150,000	June 26, 2005
150,000	0.30	150,000	May 1, 2006
720,000		720,000	

Subsequent to December 31, 2001, an additional 100,000 stock options were granted to certain directors with an exercise price of $0.30 and an expiry date of March 1, 2007.

All options that are outstanding are fully vested.

During the year, 669,500 warrants to purchase 669,500 common voting shares at $0.35 were issued. During the year 185,000 warrants expired without being exercised. The remaining 484,500 warrants will expire on June 11, 2002 if not exercised. Options and warrants have not been included in loss per share as they are both anti-dilutive.

7. COMMITMENTS

The minimum rentals payable under an office rent lease, exclusive of certain operating costs for which the Company is responsible, are as follows:

2002	$	17,691
2003		19,627
2004		13,085
	$	50,403

8. INCOME TAXES

The effective income tax rate based on the accounting loss differs from combined Federal and Provincial income tax rates. The main differences are summarized as follows:

		2001		2000
Loss before income taxes	**$**	**(876,506)**	$	(217,468)
Corporate income tax rate		**42.1%**		44.6%
Computed income tax (recovery)		**(369,009)**		(96,999)
Future tax asset not previously recognized		**(8,951)**		-
Non-deductible items and adjustments		**(13,565)**		31,445
Resource allowance		**(12,551)**		34,885
Change in income tax rates		**(11,623)**		-
	$	**(415,699)**	$	(30,669)

The components of the future tax liability are as follows:

		2001		2000
Capital assets	**$**	**238,248**	$	198,667
Non-capital income tax loss carryforwards		**(121,734)**		-
Share issuance costs		**(61,782)**		(27,137)
Other		**(13,860)**		(19,168)
	$	**40,872**	$	152,362

The Company has non-capital income tax loss carryforwards of approximately $344,137 available to apply against future years' taxable earnings. Of this amount approximately $297,000 has been recorded as part of the above non-capital loss amount. These loss carryforwards expire as follows:

2004	$	48,834
2005		16,980
2006		46,075
2007		77,400
2008		154,848

INCOME TAXES (Continued)

The company has the following estimated balances available in its income tax pools to apply against future years taxable earnings:

Cumulative eligible capital	$ 17,190
Undepreciated capital cost	359,532
Canadian development expenses	53,314
Canadian exploration expenses	722,027
Canadian oil and gas property expenses	62,881

9. STATEMENT OF CASH FLOWS

The change in non-cash operating working capital related to operations is comprised of the following:

	2001	2000
Decrease (increase) in accounts receivable	$ **205,380**	$ (151,522)
Increase in prepaid expenses	**(28,973)**	(6,868)
Increase (decrease) in accounts payable	**(229,054)**	318,500
	$ **(52,647)**	$ 160,110

The following cash payments have been included in the statement of cash flows:

	2001	2000
Interest	$ **15,829**	$ 25,929

10. FINANCIAL INSTRUMENTS

Credit Risk

Credit risk arises from the possibility that the entities to which the Company provides services may experience difficulty and be unable to fulfill their obligations. The Company is exposed to financial risk that arises from the credit quality of the entities to which it provides services. However, because of the Company's large number of customers, credit risk concentration is minimized.

Interest Rate Risk

Interest rate risk arises from the possibility that the value of, or cash flows related to, a financial instrument will fluctuate as a result of changes in market interest rates. The Company is exposed to financial risk that arises from the interest rate differentials between the market interest rate and the rates used on their financial instruments. The bank revolving loan bears a variable interest rate of prime + 1.0% and the note payable bears interest at 10%. The effective interest rate realized during the year was 9.5% (2000 - 7.0%). The average interest rate was 9.4% (2000 - 7.6%).

Fair Values

The fair values for accounts receivable, accounts payable and note payable approximates their carrying values due to the short term maturity of those instruments.

11. CONTINGENCY

The Company is presently involved in a dispute with respect to certain petroleum and natural gas properties it purchased. The vendors of these properties have filed a claim against the Company, with respect to an amount of $185,345, which they contend is owing to them with respect to the sale. The Company has reflected a liability, owing to the vendor, in the amount of approximately $45,000 in these financial statements and is planning on filing a counterclaim, in hopes of having the amount of this liability reduced. Any additional amounts which the Company may have to pay with respect to the sale of these properties will be reflected in the period of settlement of this dispute.

12. COMPARATIVE FIGURES

Certain changes have been made to the comparative figures to correspond with the current year's presentation.

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